NOTES.

THE UNREVEALED PROFITS OF PROMOTERS.

A DECISION of peculiar interest at the present time, in view of the extraordinary activity of promoters of corporate enterprises during the last two years, has just been rendered by the Supreme Court of Massachusetts in the case of the East Tennessee Land Company. The principle involved is both far-reaching and salutary. In substance it holds that promoters of a joint stock company stand in a fiduciary relation to future shareholders for all unrevealed profits incident to the formation of the company. The facts in the case were somewhat as follows. Some five individuals in Tennessee united under the name of the Phoenix Land Company, for the purpose of securing options upon some three hundred thousand acres of land in that state. They, providing the local information as their share in the enterprise, thereafter induced some prominent citizens of Boston and vicinity styling themselves The Syndicate of Ten to contribute capital, amounting to some $15,000 or more, sufficient to pay organization expenses and to secure the necessary options upon the land. This land was estimated to cost about $900,000 including $100,000 for expenses; and was then to be transferred to a corporation, the East Tennessee Land Company, the same to be capitalized at 1.5 million dollars. The difference between these sums, after repayment of costs of organization, amounting to some $700,000 was to be shared equally as profit between the members of the Phoenix Land Company in Tennessee and the Syndicate of Ten in Massachusetts.

In pursuance of this plan, as soon as one third of the options had been secured, and before the Land Company was publicly launched, the two promoting concerns issued to themselves their estimated profits of $700,000 in paid-up stock of the corporation. Nominally this $700,000 worth of stock was paid over in return for land options, which as it appeared, had in reality cost but $6000. The Company became insolvent; and this decision, is now rendered as a result of suit to recover, brought on behalf of the shareholders by the receiver. Not only does it hold the promoters liable for fraud in withholding

from the public the amount of the profits voted to themselves as directors; but also for the issuance of fraudulent and misleading prospectuses, inviting subscriptions to the stock on the basis of the statement that "the capital stock of this Company represents actual value without inflation, but does not approximate the entire value of the properties on which it is based."

It is of interest to note the parallel in a recent adjudication by the House of Lords upon a similar case in England. This also marks the victory of the shareholders of a bankrupt joint-stock company, after prolonged litigation extending over a number of years, in forcing the disgorgement of secret profits made by the promoter-directors in the flotation of the enterprise. The facts in the case of "Olympia Limited" are as follows. In 1893, it became practically certain that a spectacular resort in Kensington, Olympia Hall, for a long time identified by the Kiralfy Brothers with their well-known "Venice in London," must be sold under the hammer. One Montagu Gluckstein, Esq. and three or four others, proceeded at once to acquire rights from the debenture holders, as well as to buy up the mortgages upon the property. These they obtained at a considerable discount from their par value; a mortgage for £10,000, for example, being purchased for £500. Having done this, they then associated themselves into what they called "The Freehold Syndicate," having for its object to bid in the property when sold under foreclosure. This they did, Olympia being purchased for £140,000. This of course was to repay themselves as debenture holders and mortgages to their par value. Note a large profit, number one. On the same day, "The Olympia Company Limited" had its birth, Gluckstein *et als* Directors, which proceeded to repurchase the property from the Freehold Syndicate for the benefit of future stockholders, for the round sum of £180,000. Glowing prospectuses issued forthwith to the dear public, produced the usual results. Subscriptions to the stock at £5 a share poured in, and everything went swimmingly in a sea of watered stock. The inevitable followed; and the depleted shareholders brought suit to recover the unrevealed profits made by the promoters.

It appears that these promoters had complied with certain provisions of the English Companies Acts, requiring the cost price of the property to be made known in the prospectus. They stated, it seems, the *apparent* original purchase price, £140,000; and the fact that they as promoters had reserved to themselves the difference between this figure

and the capitalization of £180,000. What however they rigidly concealed from the stockholders was the fact that they had already made a prior profit, having really acquired Olympia from themselves on the first turn-over before the foreclosure sale, for about £20,000 less than the nominal purchase price of £140,000. To force the promoter-directors to disgorge this extra unrevealed profit of £20,000 was the purpose of the action, fully upheld as we have seen by the highest court of adjudicature in England. It was claimed by Gluckstein and his pals, that there had been in fact an adequate revelation of the facts to the directors of the company. But in the words of the learned judge, Lord Macnaghten, "'Disclosure' is not the most appropriate word to use when a person who plays many parts, announces to himself in one character what he has done and is doing in another." The rôle of Pooh Bah may appear to advantage upon the comic opera stage, but when in the stock pit it ill becomes a man of wealth or social standing.

Both these cases of Olympia Limited and of the East Tennessee Land Company are of supreme importance in the present interval of quietude subsequent upon the era of furious speculation and of joint-stock company promotion of the last two years. They are indicative of reforms especially in the line of publicity which investors and the general public are bound to demand as their right. For over three years a special committee of the English House of Lords has had under consideration a reform of the Companies Acts intended to hold both promoters and directors to a strict accountability for their official acts. Unfortunately the House of Lords is largely composed either of those honorable gentlemen of large landed estate, limited income and high social position, whose names look well upon a printed directorate; or else of lawyers whose professional gains are largely augmented by the flotation and "winding-up" of such concerns. As a result the House of Lords after several years of consideration has piously excluded from its reform program all pains and penalties against directors and promoters, as liable to discourage gentlemen from serving in such useful capacities, despite the urgent protests of all the leading financial press.

Fortunately in the United States we are not confronted with this particular evil. It is not the embryonic corporation which debauches our legislatures. But the fraudulent promoter, like the poor, is nevertheless ever with us. And a few more healthy adjudications like these will do much to abate them as a financial nuisance in the community.

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